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Nos. 97-826, 97-829, 97-830, 97-831, 97-1075,
97-1087, 97-1099 and 97-1141

IN THE
Supreme Court of the United States

OCTOBER TERM, 1997

AT&T CORP., *et al.*,
Petitioners,
v.
IOWA UTILITIES BOARD, *et al.*,
Respondents.

U S WEST, INC., *et al.*,
Petitioners,
v.
FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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REPLY BRIEF OF CROSS-PETITIONER U S WEST, INC.

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July 17, 1998

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AMENDED RULE 29.6 STATEMENT

U S WEST, Inc. advises the Court of an amendment to the company's Rule 29.6 statement to reflect a transaction and restructuring that occurred after the filing of its opening brief. U S WEST, Inc. still has no parent companies and has no non-wholly owned subsidiaries. U S WEST, Inc. has filed separately with the Court an explanation of the underlying transaction resulting in these changes.

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INTRODUCTION

In their responses to U S WEST's opening brief, the FCC and its supporters repeatedly characterize the agency's far-reaching unbundling mandates—laid out in hundreds of pages of regulations and explanations—as procompetitive rules that somehow minimize government intrusion and maximize market-based decisionmaking. Despite the FCC's apparent hope that repetition might make this claim

come true, the reality is that, while the FCC's regime undoubtedly benefits the particular *competitors* who defend it so vociferously, the agency's unbundling rules do nothing to encourage the development of *competition.* Instead, key elements of those rules impose on incumbent telephone companies regulatory obligations that will stifle investment and innovation by new entrants and incumbents alike and undermine universal service.

As the FCC admits, its rules give competitors the right to obtain and use virtually every productive asset in an incumbent's business, preassembled into a combined "platform" of network elements—and at a price set by regulators—even when an element could be readily obtained from a source other than the incumbent. Such a rule maximizes regulatory interference with the marketplace and suppresses competition by discouraging investment in rival facilities. The FCC also embraces the fact that the "platform" enables a rival to obtain the incumbent's finished services for resale at the cost-based prices that apply to unbundled network elements rather than the wholesale prices specified by section 252(d)(3). The agency does not deny that this result, by enabling new entrants to obtain the same service for resale at two different prices, allows entrants to undercut an incumbent's prices, not by providing a service more efficiently, but by engaging in regulatory arbitrage. Such arbitrage undermines universal service subsidies in direct contravention of the Act.

The FCC and its supporters defend this regime by isolating each individual aspect of the agency's decision, claiming deference for the FCC's interpretation of individual statutory phrases, and eschewing analysis of the structure and goals of the statute as "mere policy arguments." However, what the FCC dismisses as "policy" is part and parcel of the "language and design of the statute as a whole." *Sullivan v. Everhart*, 494 U.S. 83, 89 (1990). And the end result of the FCC's rules cannot be reconciled with the entirety of the statute, as reflected in its language, structure, and purposes.

Crucial to the FCC's distortion of the Act was its decision to nullify the "impair" and "necessary" standards of section 251(d)(2) for determining what network elements must be unbundled. The agency did this by refusing even to consider whether and how easily a competitor can obtain a particular element from sources other than the incumbent. The FCC and its supporters never squarely address this failing in their briefs, preferring instead to set up and attack straw men.

The FCC's failure to confront the issue is unsurprising, for its decision cannot be reconciled with the language of the Act. The FCC simply cannot, as Congress commanded, "consider" whether failure to provide access to an incumbent's element would "impair" a competitor's ability to provide service (or whether access to an incumbent's proprietary element is "necessary") without evaluating the competitor's need to obtain the element from the incumbent. And, as in the closely analogous context of the "essential facilities" doctrine, such an evaluation requires appraising the competitor's ability reasonably to obtain the same or an equivalent element from sources other than the incumbent. Such an appraisal would promote the development of vigorous competition by ensuring that new entrants are able to access facilities they truly need in order to enter the market but that are available only from the incumbent. At the same time it would leave intact the incentives for new entrants to build or obtain their own facilities when doing so is feasible, instead of relying entirely on the incumbent.

The FCC's nullification of section 251(d)(2), coupled with its unlawful expansion of the definition of "network element" and its requirement that incumbents provide network elements in a combined form, collapses the distinction drawn in the Act between network elements and resale. The agency's rules enable new entrants to obtain at cost-based rates an incumbent's finished services for resale by employing the sham of ordering all the network elements needed to provide the service on an "unbundled"

basis but precombined into a platform that provides the service.[1] The FCC and its supporters do not dispute that this device enables competitors to choose between two different prices when they purchase the same finished service for resale. Nor can they deny that the only meaningful effect of this scheme is to open the way to massive arbitrage that Congress deliberately sought to prevent and that undermines the subsidies on which state universal service programs will rely for the foreseeable future.

Instead, the FCC and its supporters point to irrelevant differences between the FCC's conceptions of unbundling and resale. None of their arguments confronts the fact that the availability of the network element platform eliminates resale under section 251(c)(4) as a distinct competitive option. In particular, contrary to the FCC's assertion, a competitor that buys the complete platform makes no commitment to specific facilities and therefore does not bear the risks that the FCC itself has identified as central to the use of network elements.

The FCC asserts that it must allow access to the complete platform because it cannot practically limit the availability of network elements. But that is an attempt to hide behind a problem of the FCC's own making. Properly implemented, section 251(d)(2) limits the unbundling requirement to those network elements that a new entrant

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[1] The expansion of the definition of "network element" to encompass vertical services and business assets that are not parts of the network was discussed in detail in U S WEST's opening brief. *See* Opening Brief of Respondent/Cross-Petitioner U S WEST, Inc. at 36-41 (May 18, 1998) ("U S WEST Br."). U S WEST incorporates by reference the discussions in the reply briefs for Bell Atlantic Corp., BellSouth Corp., and SBC Communications, Inc. and for GTE responding to the FCC's arguments concerning this issue. *See* Reply Brief for Cross-Petitioners Bell Atlantic Corp., BellSouth Corp., and SBC Communications, Inc. (July 17, 1998); Reply Brief for Cross-Petitioner GTE Midwest, Inc. (July 17, 1998). Because U S WEST and other cross-petitioners prevailed on the combination issue in the court below, it is not within the scope of this reply brief to address the FCC's most recent arguments on that issue.

cannot reasonably obtain from a source other than the incumbent. That limiting principle is both prescribed by the Act and the most sensible way to encourage the development of competition.

ARGUMENT

I. THE FCC OFFERS NO DEFENSE FOR ITS REFUSAL TO CONSIDER A COMPETITOR'S ACTUAL NEED TO OBTAIN PARTICULAR UNBUNDLED ELEMENTS FROM THE INCUMBENT.

Rather than defending the FCC's failure to consider the availability of network elements outside an incumbent's network, the agency and its supporters devote much of their discussion of the "impair" and "necessary" standards to defending against attacks that no cross-petitioner makes. The FCC asserts that its interpretation of "impair" and "necessary" is consistent with dictionary definitions, but no one has challenged the agency's definitions of these terms. FCC Reply Br. at 42-43; *see also* MCI Reply Br. at 29; AT&T Reply Br. at 43. Nor does the FCC make any headway by claiming that the statute requires it merely to "consider" the "impair" and "necessary" standards. FCC Reply Br. at 42-44; *see also* MCI Reply Br. at 28-29. Again, no one claims that these standards must always receive dispositive weight.

What U S WEST does contend is that the FCC may not evaluate the need for an element in a vacuum. The FCC may have discretion in judging the degree of need required to satisfy the "impair" and "necessary" standards and how much weight is given to this factor. But, even under the FCC's own definitions, the agency cannot "consider" whether lack of access to an element will "impair" service or whether access to a proprietary element is "necessary" without taking into account whether and how easily a competitor could procure the element from sources other than the incumbent. The FCC's refusal to undertake this analysis contravenes Congress's explicit directive.

In defense of the FCC's decision, its supporters fall back on the rationale articulated in the agency's Order—that "eventually" or "in theory" new entrants could duplicate any facility, and that therefore giving real consideration to the impair and necessary standards would eviscerate the unbundling requirements. MCI Reply Br. at 29-30. But here again, the FCC's supporters erect and knock down a straw man. U S WEST does not contend that an element may be unbundled only if it is impossible, now and forever, to obtain that element from a source other than an incumbent. Rather, our point is that the FCC cannot reasonably do what Congress required—"consider" the "impair" and "necessary" standards—without evaluating at all whether a given element can practically be duplicated from sources other than the incumbent and, to the extent that it can, whether that availability means that the incumbent should not be required to provide that element to its competitors. "Theory" has nothing to do with the issue; the focus should be on what is available *in practice* given current, actual market and technological conditions.

Moreover, an element that is available only "in theory" today may become available as a practical matter in the future as a result of technological or marketplace changes. For example, lack of access to an incumbent's local loops generally may impair a competitor's ability to provide local service today. But AT&T and TCI have promoted their recently announced plan to merge on the "theory" that it promises an alternative route for AT&T to reach consumers' homes to provide local telephone service.[2] If

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[2] *See AT&T, TCI to merge, create new AT&T consumer services unit*, Press release, June 24, 1998, *available at* <http://www.att.com/press/0698/980624.cha.html> (visited July 13, 1998); Leslie Cauley, *AT&T To Acquire TCI for $37.3 Billion—Agreement Paves the Way for Long-Distance Firm To Pursue Local Market*, Wall St. J., June 25, 1998, at A3; Hearing on the Convergence of Technologies and Consolidation in the Telecommunications Industry Before the Antitrust, Business Rights and Competition Subcommittee of the Senate Judiciary Committee (July 7, 1998) (testimony of C.

this claim is borne out in practice, the merger may mean that, in the not too distant future, lack of access to incumbents' local loops will not impair AT&T's ability to provide service. The FCC's refusal to consider alternative sources precludes it from even analyzing the effect this change might have.

Unable to defend its interpretation of the statute, the FCC asserts that its error makes no real difference because new entrants will not voluntarily depend on the incumbent and instead will use other sources if they are efficient. FCC Reply Br. at 45; *see also* AT&T Reply Br. at 43-44. Even if that were true, of course, the FCC's action still would be contrary to the statute. But the FCC's assertion is also incorrect. New entrants will have a substantial incentive to use incumbent facilities at regulatorily mandated cost-based prices even if they can reasonably duplicate or procure those same facilities elsewhere. The ability to obtain incumbent facilities at cost-based prices enables competitors to avoid the investment and risk of creating or obtaining facilities of their own. A competitor that builds its own facility takes the risk that the underlying investment may never be recovered if demand for the competitor's service is insufficient. A competitor that procures the same facility from an incumbent largely avoids that risk, since it can always abandon the facility by terminating the contract with the incumbent.[3]

Michael Armstrong, Chairman and CEO, AT&T Corp.), *available in* 1998 WL 1276107; Stephanie N. Mehta, *AT&T's Bold Projections for Earnings Unveiled in Effort To Placate Investors*, Wall St. J., June 29, 1998, at B5.

[3] Moreover, in many cases the new entrant can obtain network elements on a usage-sensitive basis, which eliminates all risk of stranded investments. *See infra* at 14-15.

The entrant's incentive to rely on the incumbent's facilities instead of building its own is further increased by the FCC's interpretation of the "necessary" standard, which permits competitors

The flaw in the FCC's analysis is confirmed by consideration of the closely analogous essential facilities doctrine under antitrust law. In that context, courts and commentators have recognized that a competitor should have access to a monopoly's facility only if that facility cannot be duplicated by the competitor and is not reasonably available elsewhere. *See* U S WEST Br. at 33 & n.13. This limitation would be entirely unnecessary if, as the FCC suggests, a competitor always would exploit a source other than the incumbent where such an alternative is reasonably available. The FCC fails to recognize the effect of mandated sharing on incentives: When the government "order[s] the [monopolist] to provide the facility and regulat[es] the price to competitive levels, then the [prospective entrant's] incentive to build an alternative facility is destroyed altogether." 3A Philip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 771b (1996). Even if the impair and necessary standards of section 251(d)(2) do not incorporate all the particular requirements of the essential facilities doctrine, they share its basic thrust—whether a competitor should be entitled to an incumbent's facility must depend, at least in part, on whether the competitor can reasonably obtain the facility elsewhere or build the facility itself.

In the height of irony, the FCC and its supporters finally suggest that the agency's refusal to consider alternative sources is appropriate because the free market should determine what facilities are duplicated. FCC Reply Br. at 22, 33-35; MCI Reply Br. at 30-31. But reliance on market forces is precisely what the FCC has prevented by issuing regulatory mandates that let competitors obtain

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to obtain all of the incumbent's proprietary elements unless the incumbent also offers equivalent, nonproprietary alternatives. That ruling enables a competitor that uses network elements to avoid any expenditures for research without taking a risk that the incumbent may obtain a competitive advantage through innovation —a risk that would exist if the competitor were to construct and utilize its own facilities.

incumbents' network elements with little or no risk, thereby squelching competitors' incentives to invest in productive assets of their own. Market forces may be insufficient, and regulation may be appropriate, where an incumbent has essential facilities that are unavailable to competitors from any other source. But where competitors can obtain needed facilities from other sources, the incumbent lacks the power to exclude them. The competitors may rely on the market and select among the multiple choices it provides (including, of course, the possibility of arriving at a mutually satisfactory arrangement with the incumbent). The FCC has supplanted this market-driven selection process by forcing incumbents to provide all facilities at prices set by regulators.

II. ALLOWING COMPETITORS TO USE NETWORK ELEMENTS TO ENGAGE IN *DE FACTO* RESALE AT COST-BASED PRICES IS CONTRARY TO THE ACT.

The cumulative effect of the FCC's rules interpreting section 251(c)(3) is to allow new entrants to buy a complete network element "platform" that, when used to provide local exchange services, is functionally equivalent to resale under section 251(c)(4). The FCC and its supporters trot out some differences between sections 251 (c)(3) and (c)(4), but all they succeed in showing is that unbundled elements can be used for additional purposes than those available through resale. What they cannot refute is that, under the FCC's rules, unbundled elements can be used to obtain the equivalent of resale at a different—and often much lower—price. As a result, section 251(c)(4) becomes simply a different pricing option for something a new entrant already can obtain under section 251(c)(3), and new entrants are free to engage in arbitrage by exploiting state-mandated price structures that reflect universal service policies. Congress did not intend any such result: It made resale a distinct competitive option under section 251(c), and deliberately prescribed a

price standard for that option that would limit easy arbitrage opportunities. A narrower reading of the Act's unbundled access provisions than that adopted by the FCC—one that does not provide access to the full "platform"—is necessary to effectuate Congress's intent.

A. The FCC and Its Supporters Do Not Refute That the Platform Eliminates Resale as a Distinct Competitive Option.

Building on its nullification of the Act's "impair" and "necessary" standards for determining what network elements should be unbundled, the FCC expanded the definition of "network element" to include nonnetwork business assets and ruled that a new entrant has the right to obtain all network elements on a precombined basis. *See generally* U S WEST Br. at 15-16. Nobody disputes that the cumulative effect of these rules is to allow new entrants to buy, at cost-based prices, the complete unbundled network element "platform"—the full, prepackaged set of "all of the network elements necessary to provide service," already "combined together" into a functional whole. MCI Reply Br. at 10, 14. In the name of "*unbundled* access," a new entrant gets a fully *bundled* final product.

The FCC and its supporters try without avail to refute the Eighth Circuit's conclusion that access to the full, precombined platform would "obliterate the careful distinctions Congress has drawn in subsections 251(c)(3) and (4) between access to unbundled network elements on the one hand and the purchase at wholesale rates of an incumbent's telecommunications retail services for resale on the other." *Iowa Utilities Board*, Order on Petitions for Rehearing, Pet. App. 71a. Their arguments never focus on the effect of access to the platform. Instead, they try to divert attention by stressing differences that exist in general between resale and the use of unbundled network elements. Nobody denies that such differences may exist; the point is that none of these differences prevents the

"platform" from being a perfect, differently priced substitute for statutory resale of local telephone service. The platform provides *everything* that the competitor can obtain through resale of an incumbent's finished service. Only the price differs.

The FCC argues that leasing unbundled network elements offers new entrants greater flexibility than resale, including the ability to design and provide services that the incumbent does not itself provide to customers. FCC Reply Br. at 38; *see also* AT&T Reply Br. at 22; MCI Reply Br. at 15. But even if selecting and combining *individual* network elements offers such flexibility, the flexibility enjoyed by a new entrant that provides service through the *complete, preassembled platform* of elements is limited at best—the new entrant using the platform by definition does not add or rearrange any facilities and hence is limited to the services that can be provided by the incumbent's existing network configuration.

Moreover, the fact that unbundled elements can be used for a broader array of services (including exchange access) than resale is beside the point: For the provision of basic local exchange service (and any other service subject to section 251(c)(4)), the platform offers a functionally equivalent alternative to resale. Under the FCC's unbundling regime, a new entrant has two options if it wishes to provide local telephone service to a particular customer without investing in any of its own facilities or taking any responsibility for configuring a network. The entrant can purchase finished local exchange service from the incumbent and resell it to the customer pursuant to section 251(c)(4). Alternatively, it can purchase the full set of network elements needed to provide local exchange service, already selected, configured, and combined by the incumbent into a functioning service—the "platform." Either way, the new entrant simply markets and sells to the end user a local exchange service that, functionally, is supplied entirely by the incumbent over the incumbent's

existing network. The only difference is that, in the first instance, the new entrant acknowledges that it is engaging in resale, while in the second it embraces the fiction that it has somehow purchased individual network components and assembled them into a finished service.[4]

In short, the FCC has made section 251(c)(4) functionally redundant; the provision does not offer new entrants any capabilities that they could not already obtain under section 251(c)(3). The fact that section 251 (c)(4) offers *fewer* services and *less* flexibility than unbundling under section 251(c)(3), *see* U S WEST Br. at 42-43; Bell Atlantic Br. at 51-52; FCC Reply Br. at 38, simply reinforces the extent to which the FCC has rendered the Act's resale provisions a dead letter (with the sole exception of an arbitrage-related purpose barred by the Act and discussed *infra* at 16-19). The FCC's broad unbundling rules permit the same type of entry strategy as resale, but with additional advantages.

The FCC argues, however, that differences in the way unbundled elements and resale services are ordered and paid for make resale less risky than unbundling and hence preserve it as a distinct competitive option. In particular, the agency argues, citing its claims in the First Report and Order, that a purchaser of unbundled elements pays a flat fee for some elements and takes the risk that it will not sell enough services to cover those costs. FCC Reply

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[4] Indeed, Reed Hundt, the Chairman of the FCC at the time the First Report and Order was adopted, recently recognized that use of the platform is effectively equivalent to resale:

> I think it has to be stipulated that real competition, competition that brings investment and innovation, that ultimately permits deregulation, that has to be essentially facility based. I think all versions of resale are transitional techniques. The [unbundled network element] platform is a version of resale.

Telecommunications Policy, Open Meeting (Ill. Commerce Comm'n, July 14, 1998) at 235 (statement of Mr. Hundt in response to question by Ms. Swanson-Hull).

Br. at 39 (citing Pet. App. 245a (Order ¶ 334)); *see also* AT&T Reply Br. at 24; MCI Reply Br. at 15-16. A reseller pays only for what it sells and thus bears no comparable risk.[5]

That *should* be a key difference between unbundled elements and resale. But the difference exists only if a new entrant, in order to compete using unbundled elements, must make a commitment to specific facilities—a commitment that cannot easily be reversed if customer demand for services using those facilities is lower than expected. Otherwise, there is no real risk in using unbundled network elements. As the FCC correctly recognized in the First Report and Order, Pet. App. 245a (Order ¶ 334), competition through unbundled elements should entail such a commitment. A new entrant that configures a network using some assets of its own and some leased from the incumbent is committed to those leased assets; it has connected its own facilities to them and has integrated them into its network, so it cannot easily reverse its choices. If the network it has configured turns out to be poorly matched to the demand for its services, the new entrant may find itself saddled with leased elements whose use is too low to justify their cost.

Where a new entrant buys the complete platform, however, it makes no such commitment and hence takes no such risk. The FCC argues that such risk exists because the new entrant must lease the local loop on a flat-rated

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[5] AT&T also suggests that a purchaser of unbundled elements bears the risk that its customers will use a particularly *high* volume of local services (for on-line or Internet services, for example), resulting in high charges for elements that are priced on a traffic-sensitive basis. AT&T Reply Br. at 25. But extra charges for high volumes are a problem only if they are not offset by extra revenues. Therefore, the risk AT&T describes would be the result of a new entrant's *self-imposed* decision to rely exclusively on flat-rate pricing to consumers; the risk easily could be avoided by combining some flat-rate fee with traffic-sensitive prices for use above specified levels.

basis. FCC Reply Br. at 39. But each customer is served by a single, dedicated local loop, and thus a new entrant leasing a particular customer's loop is assured of all that customer's business. The new entrant, in other words, knows that it will receive all revenues from that customer's local telephone use. Indeed, if the new entrant charges any type of fixed monthly fee to the customer, it will be assured of a predictable revenue stream even if the customer never uses the telephone. And because each loop corresponds to a single customer, the new entrant can cancel the loop and avoid all costs as soon as the customer changes carriers.

Nor is there substantial risk in any of the other components of the platform. Under the FCC's rules, the loop is the only significant flat-rated element that a purchaser of the platform must specify.[6] Switching (the function of routing calls) and transport (the function of carrying calls between switches in the incumbent's network) generally are priced on a usage-sensitive basis, so the new entrant pays only for what it needs.[7] And the FCC has held that a new entrant may order switching and transport as generic functions, leaving to the incumbent the task of determin-

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[6] AT&T mentions the network interface device (AT&T Reply Br. at 24) and MCI the port (MCI Reply Br. at 16) as other flat-rated elements that a new entrant must buy in order to provide service. But these elements are nothing more than the equipment that connects one end of the loop to the telephone wiring in the customer's home and the other end to the carrier's switching facilities. A new entrant purchases them together with the loop when it wins a customer and cancels them when it loses the customer. And just as in the case of the loop, the flat-rated costs of these elements easily can be recovered through a flat-rated monthly fee to the customer. In short, the reasons why the loop entails no substantial risk apply to the network interface device and the port as well.

[7] *See* J.A. 243 (Third Order on Reconsideration ¶ 30, *petitions for review pending, Southwestern Bell Telephone Co. v. FCC* (No. 97-3389 and consolidated cases) (8th Cir.)).

ing what particular facilities to use.[8] Thus, unlike a competitor that actually configures a network, a competitor that simply buys the full platform bears no risk of being committed to specific facilities that may turn out to be underutilized by consumers.

The FCC also points out that users of unbundled elements bear the cost of developing systems to bill long distance carriers for exchange access service. FCC Reply Br. at 39-40; *see also* AT&T Reply Br. at 21-22; MCI Reply Br. at 16. But a new entrant needs to develop a billing system for whatever local services it provides, regardless of whether it uses resale or unbundled elements, and the incremental cost of expanding or adapting that system to handle exchange access billing as well is not likely to be significant. Indeed, as ALTS has noted, "almost all new entrants have the back office systems and financial resources" needed to pursue a competitive strategy based on the use of unbundled network elements. ALTS Opp. Br. at 17. In any event, the minimal incremental cost of billing for access services will be more than offset by the additional revenues from those services, which are widely recognized to be priced above cost.[9] Be-

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[8] *See generally* J.A. 1359-1402 (Third Order on Reconsideration) (defining a "shared transport" element consisting of the right to use an incumbent's entire interoffice transport network without specifying particular facilities). Consistent with its apparent desire to expand the scope of the Act's unbundled access provisions wherever possible, the FCC rejected the "contention that a network element must be identifiable as a limited or pre-identified portion of the network." J.A. 246 (Third Order on Reconsideration ¶ 43). Moreover, the FCC expressly acknowledged that its intent was to shield purchasers of unbundled network elements from risk, on the theory that a new entrant attempting to select individual facilities "would almost inevitably miscalculate the capacity or routing patterns" necessary to serve its customers. *Id.* (Third Order on Reconsideration ¶ 35).

[9] *See, e.g., Access Charge Reform*, First Report and Order, CC Docket No. 96-262, FCC 97-158 (rel. May 16, 1997) ¶¶ 11, 28,

cause a carrier engaging in resale pursuant to section 251(c)(4) does not have the opportunity to collect revenues from access services, the ability of users of unbundled elements to provide those services, far from helping to preserve resale as a meaningful competitive option, simply provides an additional reason for new entrants to use the unbundled network element platform instead.

The FCC's supporters further argue that the agency's rules do not eliminate resale as a separate and viable competitive option because the wholesale price applicable to resale may, for services to some customers, be lower than the cost-based price applicable to network elements. AT&T Reply Br. at 23; MCI Reply Br. at 14. This argument simply misses the point. The flaw in the FCC's rules is not that no carrier would ever choose to label its activity as "resale." Rather, it is that the rules eliminate resale as a distinct competitive option with its own set of *real* (non-price) advantages and disadvantages. A new entrant buying the full platform of network elements pursuant to section 251(c)(3) gets everything it would get if it bought the equivalent finished service for resale; only the price is different. Thus, where cost-based prices are lower than wholesale prices—as often will be the case—a new entrant has no reason to engage in resale under section 251(c)(4). Resale is a potentially viable option *only* for services that, thanks to state universal service policies, are required to be sold to consumers at below-cost prices. In other words, the FCC's rules make resale nothing more than a vehicle to enable new entrants to exploit state pricing structures. It has no genuine competitive role.[10]

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petitions for review pending, Southwestern Bell Telephone Co. v. FCC (No. 97-2618 and consolidated cases) (8th Cir.). The FCC has begun a process to restructure access charges but estimates that it may take "several years" to complete the task. *Id.* ¶ 45.

[10] The FCC also claims that resale provides a "more immediate" entry strategy. FCC Reply Br. at 40. But since the platform comes precombined and consists of the incumbent's preexisting network

Congress did not intend such a result. The structure of Congress's scheme for promoting local competition makes sense only if the finished services a new entrant can obtain under section 251(c)(4) are *substantively* different from what it can obtain under section 251(c)(3)—not just differently priced. Congress would not have included section 251(c)(4) in the Act merely to give new entrants a second pricing option for something already available to them under section 251(c)(3). If Congress had intended simply to create a pricing alternative, it could have said so expressly in section 252(d), the section establishing "pricing standards," rather than creating an additional and independent duty under section 251(c). Similarly, Congress could not have intended, when it provided that new entrants reselling an incumbent's services would pay "wholesale rates," *see* 47 U.S.C. §§ 251(c)(4)(A), 252(d)(3), that resellers could in practice choose to pay cost-based rates instead if they merely relabeled their activity as "unbundling." For all nonsubsidized services, the FCC's rules effectively read the wholesale pricing standard of section 252(d)(3) out of the Act.

Moreover, Congress plainly did not intend to permit the arbitrage opportunities that result from allowing section 251(c)(3) to serve as a functional equivalent for resale under section 251(c)(4). *See* U S WEST Br. at 44-46. The FCC defends such arbitrage as the "market-oriented, efficiency inducing process . . . called 'competition.'" FCC Reply Br. at 30. But Congress's view, reflected in the Act, is that any benefits associated with such arbitrage are heavily outweighed by countervailing considerations. If Congress had wanted "competition" that is nothing more than the exploitation of state-mandated pricing structures by new entrants using only the

configuration, there is no reason to think that a new entrant could not obtain and begin offering services with it just as quickly as with resale.

incumbent's facilities, it would have expressly mandated cost-based rates for resale. Instead, in prescribing prices for resale—the easiest competitive option—Congress abandoned the cost-based standard it used for interconnection and unbundled elements. It adopted a special "wholesale" standard that is based on retail prices that states set to effectuate their own pricing policies. *See* 47 U.S.C. § 252(d)(3); H.R. Rep. No. 104-204, at 72 (1995) ("The [resale] rate should reflect whether, and to what extent, the local dialtone service is subsidized by other services."). The FCC and its supporters do not and cannot offer an explanation for this decision; under their theory of the Act, the adoption of a wholesale pricing standard simply makes no sense.

In fact, the wholesale pricing standard of section 252 (d)(3) has only one possible explanation: Congress recognized that the growth of competition would put pressure over time on state pricing structures, but it did not wish to allow the quick option of resale to force a flash-cut to cost-based pricing because of the destructive effect that would have on universal service. In other words, prevention of arbitrage built around universal service subsidies, far from being merely the "policy preference" of the incumbent LECs, MCI Reply Br. at 1, 2, is the policy Congress adopted in enacting section 252(d)(3). That the FCC now embraces such arbitrage with open arms is a further indication of how far the agency has strayed from Congress's vision.

The FCC also argues that universal service arbitrage, if it is a problem at all, is only temporary and hence unworthy of Congress's attention. FCC Reply Br. at 21, 32. But, as noted above, Congress *did* choose to address the issue. Nor was this an unreasonable choice; the arbitrage problem is far less "temporary" than the FCC suggests. The Act sets no timetable for state action to reform local rate structures, and, more than two years after passage of the Act, not a single state has even begun to elim-

inate implicit subsidies from local rates. And the FCC itself has argued before the Fifth Circuit that the replacement of current universal service subsidies with a new, explicit support system is "an eventual goal," not "an immediate requirement." Brief for the FCC at 49, *Texas Office of Pub. Util. Counsel v. FCC* (5th Cir.) (No. 97-60421 and consolidated cases). Congress correctly anticipated that the transition to a reformed universal service system might be slow and took action to prevent quick, resale-based arbitrage in the interim.

B. Declining To Make the Full Platform Available Would Be Neither Impractical Nor Contrary to the Goals of the Act.

The FCC and its supporters do their best to disparage any interpretation of the unbundled access provisions that would limit section 251(c)(3) to its intended scope. They repeatedly observe, for example, that the text of section 251(c)(3) contains no express restrictions on unbundling. *E.g.*, FCC Reply Br. at 20; AT&T Reply Br. at 19; MCI Reply Br. at 10. But, as discussed above, there is ample textual evidence in sections 251(d)(2) and 251(c)(4) that Congress did not intend the unbundled access obligation to be boundless and, in particular, to eclipse resale. Congress did not spell out further express restrictions because it never imagined that the FCC would try to make *everything* available as an unbundled element. Congress's vision was straightforward: New entrants may need access to certain of the incumbent's elements in order to compete, and allowing them to lease *those needed elements* at regulated prices will enable them to start competing. Congress's failure expressly to list and prohibit the various possible distortions of its statutory scheme does not leave the FCC free to take an entirely different tack. The FCC's order created a regime fundamentally different from the one Congress intended; no express prohibition is necessary to make such a course unlawful.

The FCC also suggests that there is no principled way to determine which or how many facilities a new entrant should be required to obtain on its own before turning to unbundled elements under section 251(c)(3). FCC Reply Br. at 27-28; *see also* AT&T Reply Br. at 40. If a token facility were all that was required, the limitation plainly would have little practical effect. But this problem is a red herring, created entirely by the FCC's unlawful decision to make virtually every part of an incumbent LEC's business subject to section 251(c)(3) in the first place. If the scope of section 251(c)(3) were properly limited to those facilities that a new entrant truly needs to obtain from the incumbent because they are not reasonably available from other sources, then a new entrant would not be able to provide service entirely through unbundled elements. Instead, it would have to provide some facilities on its own—namely, those facilities that are not within the bottleneck control of the incumbent. The particular facilities that are "nonessential" in this respect might vary from case to case or over time, but there is no question that the notion of "essential facilities" provides a reasonable principle for determining what facilities a new entrant must provide on its own.

Such a principle would not, contrary to the FCC's contention, "confin[e] new entrants to one option (resale)." FCC Reply Br. at 37. Unbundling would remain a viable option for many carriers, a useful and time-saving halfway house on the road to facilities-based competition. Nor would this narrower interpretation of the Act's unbundling provisions constitute an "artificial limitation." *Id.* Rather, it would simply recognize that one section of the Act may not be read so broadly as to engulf another. In short, the narrower interpretation, unlike that adopted by the FCC, would make sense of the Act's structure and effectuate Congress's purposes.

CONCLUSION

For these reasons, as well as those stated in U S WEST's opening brief, the Court should vacate the FCC's unbundling rules in their entirety.

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